IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. ~~948~~ 24

MARINE HARBOR PROPERTIES, INC.,

Petitioner,

vs.

MANUFACTURER'S TRUST COMPANY, (successor by merger to the Mortgage Corporation of New York), as trustee for the benefit of certificate holders in mortgage guaranteed by Bond & Mortgage Guarantee Company, Guarantee #181,568,

MAURICE RUBINGER, trustee of Marine Harbor Properties, Inc.,

SAMUEL SIVERMAN, additional trustee of Marine Harbor Properties, Inc.,

MORTIMER RUBENSTEIN, Foreclosure-receiver,

and

SECURITIES AND EXCHANGE COMMISSION.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

FRIEDLAND & FRIEDLAND,
Counsel for Petitioner,
Marine Harbor Properties, Inc.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

TO THE HONORABLE, THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioner, Marine Harbor Properties, Inc., (the Debtor herein), a corporation organized under the laws

of the State of New York, prays this Court for the issuance of a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit to review a decree of that Court entered January 27, 1942, reversing an order of the United States District Court for the Southern District of New York, denying an application by The Mortgage Corporation of New York, as trustee for mortgage certificate holders, to dismiss the Debtor's petition for reorganization under Chapter X of the Bankruptcy Act and to vacate its order approving the Debtor's petition.

Opinions Below.

The opinion of the District Court is part of the record (R. 70-75) and is also reported in 41 F. Supp. 814 (S. D. N. Y.), advance sheets. The majority and dissenting opinions of the Circuit Court of Appeals are not yet reported but are contained on pages 107 to 131 of the record.

Jurisdiction.

The decree of the Circuit Court of Appeals was entered January 27, 1942. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

1. Whether the relief afforded by Chapter X of the Bankruptcy Act must be denied to a mortgagor-debtor and its mortgage certificate holders merely because, some six years prior to the filing of the Chapter X petition, a modification and extension of the certificated mortgage on the Debtor's property was consented to by a state court

in proceedings conducted under the provisions of the Schackno Act (Chapter 745 of the New York Laws of 1933, as amended) and the Mortgage Commission Act (Chapter 19 of the New York Laws of 1935).

2. Whether a Debtor's petition for reorganization under Chapter X may be dismissed pursuant to Section 146(4) thereof as not having been filed in good faith, without determining whether the interests of security holders would be best subserved in prior state court proceedings, and without a showing that a procedure is available in such proceedings providing security holders with safeguards substantially equivalent to those provided by Chapter X.

3. Whether, if good faith is not lacking pursuant to Section 146(4) of Chapter X, a finding of lack of good faith in the filing of a Debtor's petition may be predicated upon an alleged personal disqualification of the Debtor arising out of previous participation in prior state court proceedings.

Statutes Involved.

The statutes involved are the following provisions of the Bankruptcy Act:

Section 141 (11 U. S. C. §541): "Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied."

Section 146 (11 U. S. C. §546): "Without limiting the generality of the meaning of the term 'good

faith, a petition shall be deemed not to be filed in good faith if— * * * (4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.'"[1]

Statement.

The Debtor's principal asset is an apartment building in New York City. The first mortgage on its property was originally held by The Title Guarantee & Trust Company, which sold participation certificates to the public, guaranteed as to principal and interest by Bond & Mortgage Guarantee Company. (R. 8)

In 1933, the Superintendent of Insurance of the State of New York, pursuant to an order of the Supreme Court of the State of New York, took possession, as Rehabilitator, of the property and business of Bond & Mortgage Guarantee Company. (R. 8, 9) Thereafter, acting under powers granted to him by the Schackno Act, the Superintendent of Insurance, with the approval of certificate holders and the state court, effectuated a modification and extension of the terms of the first mortgage on the Debtor's property, which, by agreement executed between the Debtor and Title Guarantee & Trust Company in 1935, extended the maturity of the mortgage to 1937, and re-

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[1] In the court below it was also argued that a finding of lack of good faith should have been made by the District Court because of Section 146(3) (11 U. S. C. §546 [3]) which reads:

"Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if— * * * (3) it is unreasonable to expect that a plan of reorganization can be effected".

The Circuit Court of Appeals correctly rejected this argument. (R. 110-111) On this point, Circuit Judge Frank, who dissented, was in complete accord with the majority of the Court (See his opinion at R. 117).

duced the interest thereon from 6% per annum to 5% per annum. (R. 11) In 1938, at the instance of the Mortgage Commission of the State of New York, (as successor to the Superintendent of Insurance under the Mortgage Commission Act), title to the aforesaid bond and mortgage was transferred, with the consent of certificate holders and the state court, to The Mortgage Corporation of New York as trustee for certificate holders under a Declaration of Trust which vested the mortgage trustee with enumerated powers to manage and control the trust estate until it is fully liquidated. (R. 38-44) In giving its consent, the state court expressly reserved jurisdiction to grant other relief on the application of "the trustee, or any other interested party". (R. 44) Manufacturers Trust Company is successor by merger to The Mortgage Corporation of New York. (R. 3)

The principal of the first mortgage was not paid at maturity and remained unpaid under the statutory moratorium.[1] The Debtor made all other payments until April, 1941, when it defaulted on interest and taxes. (R. 12) In May, 1941, the trustee commenced foreclosure proceedings and a receiver was appointed therein. (R. 12, 13) The Debtor, on several occasions, both before and after foreclosure, offered the trustee various proposals to further extend and modify the mortgage but the trustee never submitted any of such proposals either to the state court or to the certificate holders. (R. 13, 14)

On September 17, 1941, the Debtor filed its petition for reorganization under Chapter X. (R. 76) The petition was approved, and reorganization trustees were appointed by the District Court. (R. 96) The Mortgage Corporation of New York, as trustee, thereafter applied

[1] In 1933 foreclosure for principal defaults was suspended in the State of New York for an emergency period. (Chapter 793 of the New York Laws of 1933) The emergency period has been extended by amendments from time to time thereafter enacted and now expires July 1, 1943. (Chapter 782 New York Laws of 1941)

to the District Court to vacate its order of approval and dismiss the petition as not filed in good faith. (R. 7-21) The application was denied (R. 4-5) and an appeal from the order denying the application was taken by the mortgage trustee to the United States Circuit Court of Appeals for the Second Circuit. The Circuit Court, in a divided opinion, reversed the order of the District Court.

Specification of Errors to be Urged.

The majority of the Court below erred:

1. In holding that the Debtor's petition for reorganization under Chapter X of the Bankruptcy Act, was not filed in good faith.

2. In holding that there was an absence of good faith on the part of the Debtor because the Debtor had assented to a modification and extension of a certificated mortgage in a state court proceeding.

3. In failing to determine whether or not the interests of creditors and stockholders would be better subserved in the state court proceedings than in proceedings under Chapter X of the Bankruptcy Act, and whether or not such state court proceedings would provide for public investors safeguards equivalent to those provided by Congress in Chapter X.

4. In holding that the state court proceedings under the Schackno and Mortgage Commission Acts were "prior pending proceedings" within the meaning of Section 146(4) of Chapter X.

5. In failing to affirm, and in reversing, the order of the District Court.

Reasons for Granting the Writ.

The decision below is one of several cases decided by the United States Circuit Court of Appeals for the Second Circuit, all of which dealt with the effect of prior state court proceedings on the issue of a Debtor's good faith in the filing of a petition under Chapter X of the Bankruptcy Act. See *Brooklyn Trust Co.* v. *Rembaugh*, 110 F. (2d) 838; *In re Blinrig Realty Corp.*, 114 F. (2d) 100; *In re Castle Beach Apartments, Inc.*, 113 F. (2d) 762.[1] In all the cases cited, as well as in the present case, the question of good faith was resolved by the Circuit Court in terms of an alleged personal disqualification of the particular Debtor who attempts to resort to Chapter X of the Bankruptcy Act after participating in a prior state court proceeding instituted by other persons. The Circuit Court's rationale in the cases cited has been the subject of a good deal of adverse comment. See 18 N. Y. U. L. Q. Rev. (1941) 399, 411-413, 417-418; Siegel, *Chapter X or Schackno Act Proceedings?* (1941) 27 Corn. L. Q. 56.

The Court below concedes that in these cases there is no doubt of the jurisdiction of the District Court to entertain the Debtor's petition notwithstanding prior proceedings in a state court.[2] See *Brooklyn Trust Co.* v. *Rembaugh*, *supra*, at p. 840. The only concern of the

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[1] There have also been similar cases not reported in the Circuit Court of Appeals. See *In re 263 West 38th Street Corp.*, 37 F. Supp. 661; *In re Paloma Estates, Inc.*, C. C. H. Bankr. Serv. par. 53,336, now pending on appeal in the Circuit Court of Appeals for the Second Circuit.

[2] Section 256 of Chapter X (11 U. S. C. §656), expressly provides:

"A petition may be filed under this Chapter notwithstanding the pendency of a prior mortgage foreclosure, equity, or other proceeding in a court of the United States or of any State in which a receiver or trustee of all or any part of the property of a debtor has been appointed or for whose appointment an application has been made."

Circuit Court has been as to the propriety of the District Court's taking jurisdiction. The exercise of discretion by the District Court in approving the Debtor's petition here was overruled by the majority of the Circuit Court merely because of the prior state court proceedings and the Debtor's conduct therein. The reason for so doing was stated by the Court below thus:

> "In the *Rembaugh* case we held the element of good faith to be lacking because a debtor, which had voluntarily submitted to a plan for reorganization in the state court but found compliance therewith irksome, invoked federal jurisdiction instead of seeking relief in the state court. * * * A majority of the court is of the opinion that the *Rembaugh* case should be given effect here to prevent a debtor, who has assented to a plan which is being supervised by the state court in reorganization proceedings still pending there, from flouting that jurisdiction by filing a petition in the district court. The applicable principle, as was said in the *Rembaugh* case, is not an absence of good faith in the filing of the new petition in the broad meaning of those words but a special instance of a lack of good faith flowing from the personal disqualification of the debtor. Section 146 (11 U. S. C. A. §546) expressly disclaims any limitation upon the generality of the meaning of good faith and subsection 4 of that section is but one special instance of what will show a disabling absence of it on the part of a debtor *and is not to be confused with what controls here.*" (Italics added) (R. 112, 113)

It is not clear from the language of the majority of the Circuit Court whether its holding rests on Section 146(4) of Chapter X or on a concept of good faith not expressly defined in Section 146, although Circuit Judge Frank,

dissenting, assumed that the decision, in part at least, rests on Section 146(4). (R. 113) The resulting ambiguity requires consideration of the Circuit Court's determination from both viewpoints. We believe neither is tenable in this case.

1. The state court proceeding, which is present in this case, does not meet the requirements of Section 146(4) so as to justify the dismissal of the Debtor's petition. That section provides for a dismissal of a Debtor's petition as not filed in good faith when it appears that there is another proceeding pending in any court wherein "the interests of creditors and stockholders would be best subserved". We submit that the state court proceedings in this case do not meet this standard in comparison with the power and safety devices provided by proceedings under Chapter X of the Bankruptcy Act, and therefore should not be permitted to bar a federal reorganization.

The limitations on the *power* of the state court proceeding are exemplified in the necessity of the state court trustee to institute foreclosure proceedings to wipe out the Debtor's title to its property; the need to institute a separate and wholly independent action to cope with fraud and dishonesty (*cf. Weil v. President, etc.*, 275 N. Y. 238); and the absence of any right in the creditors to investigate the Debtor's past management, or its future prospects. However, in a federal reorganization under Chapter X of the Bankruptcy Act none of these limitations is to be found. Title to the Debtor's property vests in the reorganization trustee immediately upon his qualification as such (Section 186). And once the Court assumes jurisdiction, the disinterested trustee has the power not only to investigate the Debtor's past management, (indeed it is his duty to do so under Section 167) but power to take action against the Debtor for fraud and

mismanagement, since he possesses all of the powers of a bankruptcy trustee (Section 187).

In the matter of *safety*, there are many reasons why the federal proceeding is superior to state reorganizations. In the first place, the doctrine of absolute priorities, enunciated in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, is applicable in Chapter X, but finds no currency in state court reorganizations. Secondly, the structure of Chapter X offers protective devices in cases where the liabilities exceed $250,000, as in this case, that are wholly absent in the state courts.

The reorganization trustee and his attorney must be disinterested (Sections 156-8). The reorganization trustee, upon appointment and qualification, must investigate the property, the Debtor's prior management and operation of the property, and the desirability of its continuance (Section 167[1]). The trustee must also report to the judge any fraud, misconduct or mismanagement (Section 167[3]). The results of these investigations are then sent to creditors and stockholders, who are asked to suggest proposals to be included in a plan (Section 167[5],[6]). Before approving a plan, the District Court may seek the aid of the Securities and Exchange Commission for an advisory report (Section 172). A hearing on a plan is then had, on notice to creditors and stockholders (Section 171). Solicitation of acceptances to a plan is prohibited until after the District Court approves the plan (See Section 176). The District Court, before approving a plan, must inquire as to its fairness, examine into the new capital structure; make a finding that the earning capacity of the new enterprise will be sufficient to meet fixed charges; determine that the distribution of new securities (if no cash settlement is made) reflects existing rights and are equitably treated. (*Case* v. *Los Angeles Lumber Co., supra*, at p. 115; *Consolidated Rock Products Co.* v. *DuBois*, 61 Sup. Ct. 675) After the plan

is thus scrutinized by the District Court, usually assisted by the Securities and Exchange Commission, it is submitted, with other available data and reports, to the interested parties for their consideration (Section 175). When the plan has been accepted by the necessary majorities, a hearing is held for its confirmation upon due notice to all creditors and stockholders (Section 179). If the plan is fair, equitable and feasible, and if its proposal and acceptance are in good faith and not in violation of any of the prohibitions contained in the Act, it will be confirmed (Section 221[2]). The Court's investigation does not stop here but is directed even to the methods by which the management of the reorganized corporation is to be chosen in order to insure adequate representation for the interests of all creditors and stockholders (Section 221[5]). To that end, the District Court may pass upon the qualifications of the management and voting trusts, if any, upon the consummation of the plan (Section 216[11]).

In all of these ways every possible safeguard is provided for the protection of every class. The Schackno Act, on the other hand, does not provide for corresponding safeguards. Particularly is it lacking in a device whereby the creditors, secured or unsecured, and the stockholders can receive a full and impartial report from a disinterested trustee. It is contended that in state court procedures there is such a safeguard in the form of the Bureau of Trust Supervision, an agency allegedly created by Chapter XIX of the Laws of 1940, New York, amending Section 17-a of Chapter XIX of the Laws of 1935, New York. However, the record fails to disclose any evidence showing the nature of the duties and obligations of this alleged agency, the facilities it has to properly assist and advise the Court and creditors on proposed plans, or a history of achievement in the field of reorganization.

For all of the above reasons it is respectfully submitted that the state court proceeding, present in this case, does not meet the requirements of Section 146(4) in that it does not appear that therein the interests of creditors and stockholders will be best subserved.

2. The Debtor's prior conduct in the state court does not disqualify it from reorganization in the federal court. The decision of the majority of the Circuit Court below holds, in effect, that the Debtor herein is forever bound to remain in the state court. This disqualification is based on the Debtor's agreeing, some 6 years ago, to a modification and extension of its mortgage in the State proceeding. Therefore, the Circuit Court would deny this Debtor, or any Debtor who had ever invoked, or had otherwise been subject to, the jurisdiction of the state court, the right to enter the federal court for the purpose of reorganizing. And this disqualification would attach to every Debtor, regardless of any change in circumstances. Neither would it matter that the State procedure would not best subserve the interests of creditors and stockholders. Neither would the absence of any pending State procedure assist in opening the doors of the federal court to a distressed Debtor. The only test to be applied, according to the Circuit Court below, is—did the Debtor ever voluntarily submit, or was it ever subject to, the jurisdiction of the state court? If so, then the federal court is to remain forever closed to such a Debtor and the remedies of Chapter X are to remain unavailable.

Far from being disqualified by its participation in the state court proceedings, the Debtor, in this case, should be welcomed into the federal court. For the Debtor herein, on several occasions, entered into negotiations looking to a further modification of its mortgage, but the trustee of the certificate holders declined the Debtor's

several proposals after submitting them only to its Trust Committee. "No submission of the proposed modification was made either to the Court or to the certificate holders" (opinion of District Court, R. 72). The Debtor was thus "rebuffed by the trustee and has had no opportunity to make application for the relief which obviously the situation requires" (opinion of District Court, R. 73).

It seems clear that, particularly in this case, the Debtor should not be held personally disqualified from entering the federal court after being summarily rebuffed by the trustee of the certificate holders. The Circuit Court below would ignore, however, this *impasse* and hold that having been subject to the jurisdiction of the state court, six years back, the Debtor is bound to remain there.

We think that this holding is narrow, unjust, and in direct conflict with the intention of Congress when enacting Chapter X. When the Chandler Act was enacted in 1938, there was hardly one mortgage guaranty company (which had sold mortgage participation certificates to the general public) that was not in some stage of rehabilitation or liquidation in the state courts.(4) At one time or another, since the advent of the depression that followed 1929, every Debtor of these mortgage guaranty companies voluntarily submitted, or was otherwise subject, to the jurisdiction of the state court. Thus, if the holding of the Circuit Court is permitted to stand, Federal treatment of this entire situation, on the Debtor's application, would be forever barred for the simple reason that every Debtor of mortgage guaranty companies is personally disqualified to do so.

(4) In New York State alone, the corpus of existing guaranty certificated mortgages exceeded in value $700,000,000. In this corpus over 200,000 persons held participating interests. *Report to His Excellency, Herbert H. Lehman, Governor of the State of New York, by George W. Alger, dated October 5, 1934, on p. 5.*

Conclusion.

Section 146(4) refers to a situation in which good faith will be presumed absent if there is a "prior proceeding pending wherein it appears that the interests of creditors and stockholders would be best subserved". No other standard, such as the Debtor's alleged personal disqualification, was provided by Congress to justify a finding of an absence of good faith under this subdivision. Nevertheless, the Circuit Court below undertook to deny to creditors and stockholders the protective devices of Chapter X, and the beneficial results that were to be derived from its application, because of the alleged personal disqualification deemed to exist on the part of the Debtor.

Thus the objective standard of bad faith, as defined by Section 146(4), appears to have been replaced by a new and subjective standard, not provided for therein. As a consequence the majority of the Circuit Court failed to determine directly whether or not the state court proceeding was one wherein the interests of creditors and stockholders would be best subserved. That question is of tremendous importance to the real estate mortgage situation which, since 1929, has afflicted our country. It is today a Federal question which should be, but has not been, decided by this Court.

Wherefore, petitioner prays that this petition for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit, should be granted.

Dated: February 11th, 1942.

Friedland & Friedland,
Counsel for Petitioner,
Marine Harbor Properties, Inc.

State of New York, }
County of New York, } ss.:

SOL FRIEDLAND and ARTHUR E. FRIEDLAND, being duly sworn, depose and say, that they are counsel for the petitioner named in the foregoing petition. That they prepared the same and that the allegations thereof are true as they thoroughly believed.

SOL FRIEDLAND.
ARTHUR E. FRIEDLAND.

Subscribed and sworn to before me this
11th day of February, 1942.

MURRAY WALDMAN,
Commissioner of Deeds, New York City,
Term Exp. June 11, 1942,
N. Y. County Clerk's #56.